Statement of
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Chairman Camp and Ranking Member Levin -- thank you for the opportunity to testify at this hearing. I am a principal in the Groom Law Group, a law firm located in Washington, DC that focuses exclusively on employee benefits law. Prior to joining the Groom Law Group, I was the Benefits Tax Counsel in Office of Tax Policy at the U.S. Department of the Treasury from 2001 to 2005. I will testify today about the simplification proposals for retirement savings accounts we developed in the Office of Tax Policy and that were included in the Bush Administration's budget proposals for Fiscal Year 2004 and 2005. Please note that I am speaking today on my own behalf and am not speaking on behalf of the firm or any firm clients in my testimony.

The Joint Committee on Taxation estimates that tax expenditure for pension contributions and earnings is over $700 billion and over $87 billion for traditional and Roth IRAs.[1] Retirement savings is the largest tax expenditure after the tax exclusion for employer provided health care.

While some critics suggest that the current system – and tax expenditure -- do not result in adequate retirement replacement rates, it is important to note that other studies show that these plans can and do provide adequate retirement replacement income, particularly when taking into account the income form Social Security. [2]

Reasons for Simplification

The Internal Revenue Code currently provides various savings incentives for individual retirement savings, for employer-based retirement savings and for other savings objectives, such as the payment of medical expenses or education expenses. All these different savings vehicles have different eligibility requirements and the amount of the tax benefit could change based on the individual's income status or his or her participation in other savings programs.

Individual Retirement Savings Vehicles. For individual retirement savings, the choice is whether to make a pre-tax contribution to a traditional individual retirement account (IRA), make an after-tax contribution to a traditional IRA or make an after-tax

[1] Estimates of Federal Tax Expenditures for Fiscal Years 2011-2015 prepared for the House Committee on Ways and Means and the Senate Committee on Finance by the Staff of the Joint Committee on Taxation, January 17, 2012.
[2] Peter J. Brady. Can 401(k) Plans Provide Adequate Retirement Resources? *Public Finance Review* March 2012 40: 177-206.

contribution to a Roth IRA. The type of contribution an individual is eligible to make and the amount of the contributions is dependent on the individual's modified adjusted gross income and whether the individual is covered by an employer-sponsored retirement plan. The following charts (taken from IRS publications and websites) will illustrate the difficulty in knowing whether an individual is eligible to contribute to the various types of IRAs.

2011 IRA Deduction Limits - Effect of Modified AGI on Deduction if You Are Covered by a Retirement Plan at Work

If Your Filing Status Is...	And Your Modified AGI Is...	Then You Can Take...
single or **head of household**	$56,000 or less	a full deduction up to the amount of your contribution limit.
	more than $56,000 but less than $66,000	a partial deduction.
	$66,000 or more	no deduction.
married filing jointly or **qualifying widow(er)**	$90,000 or less	a full deduction up to the amount of your contribution limit.
	more than $90,000 but less than $110,000	a partial deduction.
	$110,000 or more	no deduction.
married filing separately	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.
If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.		

2011 Deduction Limit - Effect of Modified AGI on Deduction if You Are NOT Covered by a Retirement Plan at Work

If Your Filing Status Is...	And Your Modified AGI Is...	Then You Can Take...
single, **head of household, or qualifying widow(er)**	any amount	a full deduction up to the amount of your contribution limit.
married filing jointly or **separately** with a spouse who **is not** covered by a plan at work	any amount	a full deduction up to the amount of your contribution limit.
married filing jointly with a spouse who **is** covered by a plan at work	$169,000 or less	a full deduction up to the amount of your contribution limit.
	more than $169,000 but less than $179,000	a partial deduction.
	$179,000 or more	no deduction.
married filing separately with a spouse who **is** covered by a plan at work	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.
If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.		

2011 Deduction Limit – Effect of Modified AGI on Roth IRA Contribution		
This table shows whether your contribution to a Roth IRA is affected by the amount of your modified adjusted gross income (modified AGI).		
If you have taxable compensation and your filing status is…	**AND your modified AGI is…**	**THEN…**
married filing jointly or qualifying widow(er)	less than $169,000	you can contribute up to $5,000 ($6,000 if you are age 50 or older) as explained under How Much Can be Contributed.
	at least $169,000 but less than $179,000	the amount you can contribute is reduced as explained under Contribution limit reduced.
	$179,000 or more	you cannot contribute to a Roth IRA.
married filing separately and you lived with your spouse at any time during the year	zero (-0-)	you can contribute up to $5,000 ($6,000 if you are age 50 or older) as explained under How Much Can be Contributed.
	more than zero (-0-) but less than $10,000	the amount you can contribute is reduced as explained under Contribution limit reduced.
	$10,000 or more	you cannot contribute to a Roth IRA.
single, head of household, or married filing separately and you did not live with your spouse at any time during the year	less than $107,000	you can contribute up to $5,000 ($6,000 if you are age 50 or older) as explained under How Much Can be Contributed.
	at least $107,000 but less than $122,000	the amount you can contribute is reduced as explained under Contribution limit reduced.
	$122,000 or more	you cannot contribute to a Roth IRA.

Employer-Sponsored Retirement Savings Vehicles. Employer-sponsored retirement savings vehicles present their own level of complexity. The first level of complexity is the choice of retirement savings vehicle. Under the Internal Revenue Code, there are a number of tax-favored, defined contribution retirement savings vehicles that employers can adopt, including the following types of plans: 401(k) plans, 403(b) plans, 457(b) plans, SIMPLE 401(k) and IRAs, thrift plans, and salary reduction simplified employee pensions (SARSEPs).

401(k) plans. Private employers may establish 401(k) plans, which allow participants to choose to take compensation in the form of cash or a contribution to a defined-contribution plan (elective deferral). Annual deferrals under a 401(k) plan may not exceed $17,000 in 2012. Participants aged 50 or over may make additional "catch-up" deferrals of up to $5,500. Elective deferrals are fully vested immediately.

401(k) plans are subject to an actual deferral percentage (ADP) test, which generally measures and compares highly compensated and non-highly compensated employees' elective-deferral rates. Three 401(k)-plan "safe-harbor" designs based on the employer matching contribution provided are deemed to satisfy the ADP test automatically. "Catch-up" contributions are not subject to the ADP test.

SIMPLE 401(k) Plans and IRAs. Employers with 100 or fewer employees and no other retirement plan may establish a SIMPLE 401(k) plan or IRA. Deferrals by SIMPLE participants may not exceed $11,500 in 20012. SIMPLE participants aged 50 or over may make additional "catch-up" deferrals of up to $2,500. All contributions are immediately fully vested. In lieu of the ADP test, SIMPLE plans are subject to special contribution requirements, including a lower annual elective deferral limit and either a matching contribution not exceeding 3 percent of compensation or a non-elective contribution of 2 percent of compensation (with certain special rules for SIMPLE IRAs).

Thrift plans. Employers may establish thrift plans under which participants may choose to make after-tax cash contributions. Such after-tax contributions, along with any matching contributions that an employer elects to make, are subject to the actual contribution percentage (ACP) test (without the availability of an ACP safe harbor). Employee contributions under a thrift plan are not subject to the $17,000 limit that applies to employee pre-tax deferrals.

Roth-treatment of contributions. Participants in 401(k), 403(b) and governmental 457(b) plans can elect Roth treatment for their contributions – i.e., contributions are made on an after-tax basis and distributions are excludible from income. Roth contributions must be accounted for in a separate account. There are no required minimum distributions during an employee's lifetime.

Salary reduction simplified employee pensions (SARSEPs). Employees can elect to have contributions made to a SARSEP or to receive the amount in cash. The amount the employee elects to have contributed to the SARSEP is not currently includible in income and is limited to the dollar limit applicable to employee deferrals in a 401(k) plan. SARSEPs are available only for employers who had 25 or fewer eligible employees at all times during the prior taxable year and are subject to a special nondiscrimination test. The rules permitting SARSEPs were repealed in 1996, but employee deferral contributions can still be made to SARSEPs that were established prior to January 1, 1997.

403(b) plans. Section 501(c)(3) organizations and public schools may establish tax-sheltered annuity plans, also called 403(b) plans. In general these plans are subject to similar but slightly different rules than 401(k) plans. Benefits may be provided through the purchase of annuities or contributions to a custodial account invested in mutual funds. Contribution limits (including catch-ups), deferral limits, and minimum distribution rules are generally the same as for 401(k) plans. However, certain employees with 15 years of service may defer additional amounts under a complicated three-part formula. Certain 403(b) plans are subject to nondiscrimination rules.

Governmental 457(b) plans. State and local governments may establish Section 457(b) plans. In general, these plans are subject to similar but different rules than 401(k) plans. Participant contributions and plan earnings generally are tax-deferred until withdrawal. Participant elective contributions may not exceed the lesser of 100 percent of compensation or $17,000 in 2012. However, participants may make additional contributions of up to twice the standard amount in the last three years before normal retirement age. Participants aged 50 or over may make additional "catch-up" contributions of up to $5,500.

Nondiscrimination Rules and Employer-Sponsored Plans. Multiple nondiscrimination rules add complexity to the administration of these plans. The nondiscrimination rules are a means of making sure that lower-paid employees share in the benefits provided under retirement savings plans. However, commentators have noted that the benefit accruing to lower-paid workers due to the nondiscrimination rules needs to be weighed against the cost to workers who do not have a 401(k) plan due to the nondiscrimination rules. The Office of Tax Policy during the Bush administration recognized that complexity in the administration of establishing and administering a 401(k) plan is cited as a primary reason that small businesses were reluctant to establish savings plans, so we looked to eliminate requirements that were overly complicated or redundant.

Congress has changed the nondiscrimination rules several times over the years. For example, SIMPLE 401(k) plans, introduced in 1996 and available to employers with fewer than 100 employees, have less administrative burdens and more flexible rules than standard 401(k) plans. Congress has also provided "safe harbor" plan designs whereby if the employers that provide certain levels of matching or nonelective contributions are deemed to satisfy the nondiscrimination test.

Administration's Savings Proposals.

The Bush Administration's 2004 budget proposal outlined a simplified system of tax-favored savings with only three types of tax-favored savings vehicles: Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs), and Employer Retirement Savings Accounts (ERSAs). In the following year's budget proposal, the Administration proposed similar simplification measures – modified to reflect comments we received from retirement policy experts.

Lifetime Savings Accounts. Individuals would be able to contribute $5000 on an after-tax basis to an LSA. Amounts contributed would grow on a tax-free basis. There would be no income limitations on who could contribute to an LSA.

Distributions from these accounts could be made at any time regardless of the individual's age and could be used for any reason by the account holder. Survey data has shown that younger and lower-income households are less likely to cite retirement as the primary reason that they save. Every three years, the Federal Reserve Board conducts the Survey of Consumer Finance (SCF), which asks households detailed questions about their balance sheets and incomes. The survey also asks households what they consider their most important reason for saving. According to the most recent SCF data (2007), 37 percent of households headed by an individual aged 21 to 64 reported that the most important reason for savings was for retirement. Another 29 percent of households reported they were primarily saving for "liquidity" or precautionary savings to guard against unexpected circumstances. The next most common reasons for savings were education, home purchases and future purchases. Based on this data, we believed that individuals with limited means to save would be more willing to contribute to an LSA because they would be comfortable that the money saved in the LSA could be used in the event of an emergency.

Retirement Savings Accounts. Individuals also could contribute $5,000 (or earnings includible in gross income, if less) on an after-tax basis to an RSA, with account earnings growing on a tax-free basis. Like the LSA, no income limits would apply to contributions to an RSA. Qualified distributions – i.e., any distributions made after an individual attained age 58 or in the event of death or disability -- would be tax free. All other distributions would be considered non-qualified distributions and would be included in income to the extent that the distribution exceeds basis and would be subject to a 10 percent additional tax.

Transition Issues with LSAs and RSAs. While simplification was the goal, moving from the current tax regime to another raised transition issues. For example, existing Roth IRAs would be renamed RSAs and subjected to the new RSA rules, whereas existing traditional IRAs would be converted into RSAs with the conversion amount includible in income – much like the conversion rules when Roth IRAs were enacted. The income recognized by these conversions could be spread over a 4-year period. Medical Savings Accounts, Archer MSAs, Coverdell Education Saving Accounts, and Qualified State Tuition Plans also could be converted to an LSA.

Modification of the LSA and RSA Proposal. After the Bush Administration's proposal was first released in the Fiscal Year 2004 budget proposal, the Office of Tax Policy meet with many interested parties, some of whom pointed out that the proposals could result in fewer savings opportunities available for employees who worked in small businesses. Some groups noted that the savings opportunities available through the LSA and RSA might result in small business owners deciding that their retirement savings needs were adequately addressed through the LSA and RSA and opting not to offer employees an employer-based savings vehicle. Changes were made in the Fiscal Year 2005 budget proposal to address those concerns and help ensure that simplification did not to result in fewer savings opportunities.

Employer Retirement Savings Accounts. ERSAs would be available for all employees regardless of the type of employing entity. ERSAs generally would follow the existing rules for §401(k) plans, including the 401(k) contribution limit,[3] the catch-up contribution limit for employees age 50 and above and the availability of Roth-type contributions.

The nondiscrimination testing rules would be simplified. Under the proposal, the average contribution percentage of highly compensated employees could not exceed 200 percent of the non-highly compensated employees' average contribution percentage. However, if the non-highly compensated employees average contribution percentage exceeded 6 percent, the plan would be considered to be effectively providing savings opportunities for the non-highly compensated employees and, like the current law safe harbor plan designs, no further nondiscrimination testing would be required. Like current law, the proposal would provide for design-based safe harbors based on the amount of employer matching contributions. Finally, as under current law, there would be different nondiscrimination testing rules for state and local governments and certain tax-exempt organizations and the proposal did not attempt to change those requirements.

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Even though these simplification efforts did not advance in Congress -- although it is worthwhile noting that Rep. Sam Johnson (R-3rd TX) did introduce legislation regarding the LSAs -- the effort to review and recommend comprehensive changes to the current savings system was, I believe, worthwhile. Any effort to advance tax reform will likely include a review of the retirement savings incentives. If one goal of tax reform is to simplify the current system, I would recommend that the Committee examine the work of the Office of Tax Policy during the Bush administration.

Thank you for this opportunity to address the Committee. I will be happy to answer any questions the Committee may have.

[3] Support among American Households for maintaining current contribution limits is substantial. See, for example, *America's Commitment to Retirement Security: Investor Attitudes and Actions*, January 2012, a report by The Investment Company Institute, showing among other things, that 83 percent of households surveyed do not want the contribution limits lowered.